Beneficial Ownership: To tell or Not to Tell?

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Beneficial ownership and illicit financial flows (IFFs)

Illicit Financial Flows (IFFs) are one of several impediments to achieving sustainable development in developing countries across the world. While there is no globally accepted definition of IFFs, there is global acceptance that IFFs undermine the efforts of developing countries to generate domestic revenues to finance their national development agendas. According to the United Nations (UN), developing countries face an estimated annual funding gap of $2.5 trillion to deliver on Agenda 2030. In Africa, the continent loses approximately $100 billion annually through IFFs that are generated in and moved from the continent to tax havens.

IFFs result from complex and intricate sets of structures across multiple jurisdictions, developed to be as opaque as possible from authorities for all manner of reasons. According to the Organisation for Economic Cooperation and Development (OECD), these structures can lead to domestic tax base

erosion and profit shifting (BEPS) due to multinational enterprises exploiting gaps and mismatches between different countries' tax systems. They further estimate these practices cost countries $240 billion annually due to tax avoidance by multinational companies, which is the equivalent to 4-10% of the global corporate income tax revenue. Developing countries' higher reliance on corporate income tax means they suffer from BEPS disproportionately.

Furthermore, these opaque and complex structures give rise to activities that are corrupt or involve some level of criminal activity; however, there are situations where these structures are legal. In both instances, this complexity across multiple jurisdictions and the role of ‘shadow’, ‘shell’, and ‘letterbox’ registration make it difficult for authorities to determine who the real legal or beneficial owner is. Therefore, linking the beneficial owner to the proceeds of corruption and other crimes is notoriously difficult. According to Transparency International, “*Secrecy jurisdictions play a major role in receiving illicit financial flows. Governments should establish mandatory, public registers that disclose the beneficial ownership of trust funds and companies to allow illicit financial flows to be more easily traced and make it harder for people to benefit from the proceeds of corruption and crime.*”

To Tell OR Not to Tell?

Combatting IFFs from developing countries that travel through the international financial system and end up in secrecy jurisdictions requires interventions at all levels. Beneficial ownership registers are an important set of interventions for regulatory and investigative authorities who wish to determine who the real owners of business entities are. A beneficial owner is the natural person who ultimately owns, controls, or benefits from a company or trust and the income it generates (Global Witness 2014; Transparency International 2014). Beneficial ownership registers are part of the wider transparency agenda that seek to disclose the activities, owners, and profits of multinational corporations as well as high net-worth individuals and politically exposed persons. This is because, in many instances, businesses as well as individuals (usually high net-worth and politically exposed persons) tend to take advantage of loopholes, weak laws or poor enforcement and set up ‘special purpose vehicles’ or ‘shell companies’ as the beneficial owner.

The importance of introducing registers to catalogue who the actual beneficiaries are from activities within a jurisdiction is to enable authorities to improve transparency of transactions as well as to appropriately conduct investigations in the instance of suspicion of criminality. Given the complexity and the multijurisdictional structure of businesses, determining who the real beneficial owner is can prove a challenge.

As recent exposés such as the Panama Papers, Paradise Papers, Lux Leaks, and Mauritius Leaks show, there are several mechanisms and approaches that both businesses and individuals use to cover or hide their activities from the authorities, either because some wealth is from criminal activities, or as a way to minimise liabilities in one jurisdiction. The enactment of beneficial ownership legislation can go a long way in shedding light on the activities (legitimate or otherwise) of businesses and individuals. It can further illuminate the operations of these complex structures that support tax base erosion in developing countries. This point is further evidenced by The Financial Action Task Force (FATF) in 2011 which shows that in 28 out of the 32 cases analysed, the transgressing parties involved (or their families) made use of corporate vehicles to hide the actual beneficiaries. "Gatekeepers" such as lawyers or accountants were used in 14 cases. The World Bank's Star Initiative review of 150 grand corruption cases also shows that corporate vehicles were used to hide allegedly illicit money in almost all cases.

During the 10th Annual Conference of the Pan-African Lawyers Union (PALU), the merits and demerits of beneficial ownership registers highlighted an age-old debate between transparency and privacy. Professional service providers often argue transparency initiatives such as beneficial ownership risk creeping into the realm of privacy and unduly exposing clients. This argument might hold water if the professional services did not resort to bending rules to deflect the pressures of transparency from their clients. The PALU conference posited this was a legitimate way of protecting ones' clients from the spotlight of unwanted attention. However, it was noted, while this was a genuine concern, a line needed to be drawn between seeking transparency of owners, and the transgression into the privacy of clients. A common feature in these complex multijurisdictional entities is the use of 'special corporate vehicles' often registered in the name of the professional service provider to veil the client

from being known. Purcell and Rossi (2019) suggest there are ways in which stronger transparency provisions need not overstep the mark on privacy concerns. For example, (i) Public access does not necessarily mean publishing the entire content of declarations submitted by public officials. Highly sensitive information, such as bank account numbers, is always kept confidential; (ii) making public only the declarations of high-level public officials; and (iii) recognising ultimately, the public interest outweighs personal privacy for high-level officials.

The concerns raised on the grey area between transparency and privacy are to be treated with care especially when considering developing country contexts where the political class tends to be both the lawmakers as well as the lawbreakers! To this end, appreciating the trade-offs associated with increasing transparency while at the same time maintaining levels of privacy are important if there are meaningful reforms in the offing, however, these considerations should not be an excuse to not act on fighting IFFs. The PALU conference appreciated this position and also considered the role of professional services in self-regulating. Speaking at the Conference, ISLP Programme Director for Tax posited: "*I am struck by the dichotomy that is confronting professional services, and that is where do they place themselves in between the rights of citizens affected by the actions of their clients? Is there a moment in time where they might want to humanise themselves when determining the impact of enabling a client who transgresses the law which impacts citizens?*"

There is no doubt about the opportunity of passing legislation that creates beneficial ownership registers presents for developing countries to set in place the foundation of curbing IFFs from their countries. In complementing these laws and regulations, professional service providers are beginning to adjust their behaviour and practices. For example, financial institutions are now required to pay closer attention to their customers through the 'know your customer' regulations aimed at flagging suspicious transactions; other professional service providers are also coming under increasing pressure to amend their practices in requiring them to report suspicious transactions on behalf of or for a client. This complementarity between pushing for greater transparency as well as more vigilantly regulating professional services will

contribute immensely towards curbing IFFs from developing countries.

According to the World Bank: "*transparency of beneficial ownership will help ensure that the puppet masters and their associates and facilitators are not able to operate in secrecy and impede development. The Stolen Asset Recovery Initiative (StAR) and the Financial Market Integrity Unit have been providing targeted technical assistance on beneficial ownership to financial centres, including offshore centres and more developing countries in the context of understanding how the corrupt can hide their stolen assets through legal structures*."

The Truth is Out There!

Improving the environment by which business can be done in a transparent and legal manner is central to developing countries being able to overcome the vicious cycle of poverty, and dependency. IFFs cost developing countries billions of dollars and with that the opportunity to self-determination. The veil of secrecy that often covers international financial systems and international business needs to be reformed and at the centre of this reform is the role of professional services who need to pay greater attention to their part in perpetuating vicious cycles in the name of client privilege. Beneficial ownership registers are not the panacea for fighting IFFs however, they are the first step in right the direction The truth of how these structures work and to whom they are linked is out there and in countries like the Denmark, UK, Norway, Sweden, Pakistan, South Africa, Ghana, Kenya and many others, the truth is slowly being revealed! IFFs are a global problem that has national impacts. Addressing IFFs requires both concerted global action as well as strong-willed national legal, policy, and regulatory reform that both discourages and punishes transgressors of the law.

For more information on this article and ISLP's work on tax write to: jbraganza@islp.org **Some useful references and resources** Hiding beneficial owners of companies hampers efforts to curb illicit financial flows, meet Sustainable Development Goals: https://www.business-humanrights.org/en/africa-columnist-sceptical-about-measures-to-curb-illicit-financial-flows-by-multinationals Pietro Toigo, African Development Bank Group, August 2016 Beneficial Openness: Is More Transparency Always Better?

https://www.cgdev.org/blog/beneficial-openness-more-transparency-always-better Maya Forstater, April 2017 Learning the lessons from the UK's public beneficial ownership register https://www.openownership.org/uploads/learning-the-lessons.pdf October 2017 Transparency v privacy https://www.forsters.co.uk/sites/default/files/ForstersLLP_TransparencyVPrivacy_PropertyLa Laura Williamson, Forsters LLP, March 2017 Owning Up: Options for Disclosing the Identities of Beneficial Owners of Extractive Companies https://resourcegovernance.org/sites/default/files/nrgi_Beneficial%20Owners20150820.pdf Aaron Sayne, Erica Westenberg and Amir Shafaie, August 2015, NRGI Beneficial ownership verification: ensuring the truthfulness and accuracy of registered ownership information: https://www.taxjustice.net/wp-content/uploads/2019/01/Beneficial-ownership-verification_Tax-Justice-Network_Jan-2019.pdf Andres Knobel, January 2019, TJN Privacy vs Transparency https://www.imf.org/external/pubs/ft/fandd/2019/09/pdf/illicit-financial-flows-and-privacy-vs-transparency-purcell.pdf Jay Purcell and Ivana Rossi, IMF Legal Department, Finance & Development, September 2019 Illicit Financial Flows from Developing Countries: Measuring OECD Responses https://www.oecd.org/corruption/Illicit_Financial_Flows_from_Developing_Countries.pdf OECD 2014 Policy Coherence in Combating Illicit Financial Flows: PCSD Thematic Module https://www.oecd.org/gov/pcsd/IFFs%20thematic%20module%20v12cl_for%20web.pdf The African Union calls for Company Ownership Transparency to Tackle Illicit Financial Flows https://www.globalwitness.org/pt/blog/african-union-calls-company-ownership-transparency-tackle-illicit-financial-flows/Rosie Sharpe, Global Witness 2015 The state of play of beneficial ownership registration: A visual overview https://www.taxjustice.net/wp-content/uploads/2018/06/TJN2018-BeneficialOwnershipRegistration-StateOfPlay-FSI.pdf Andres Knobel, Moran Harari, Markus Meinzer, June 27 2018, TJN Know Your Client: Should Lawyers Be Regulated Like Financial Institutions? https://www.trulioo.com/blog/know-your-client/ APRIL 4, 2019

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